CONSTRUCTIVE KNOWLEDGE OF A SUBROGATION AGREEMENT PREVENTS TORTFEASOR'S DEFENSE BASED ON A GENERAL RELEASE

Motorists Mutual Insurance Co. v. Gerson
113 Ohio App. 321, 17 Ohio Op. 2d 333, 177 N.E.2d 790 (1960)

The insured's automobile, which was insured by a $50 deductible collision policy with the plaintiff, was involved in a collision with a truck driven by the defendant. Plaintiff paid its insured $119.61 and entered into a subrogation agreement with him on August 14, 1958. At some time thereafter, defendant's insurer visited plaintiff's insured and obtained a general release of all claims against defendant for a consideration of $50. Plaintiff brought an action for the amount of its subrogated claim. The trial court found that the defendant was negligent, but held for the defendant because of the general release given by plaintiff's insured. The court of appeals reversed and entered final judgment for plaintiff, holding that defendant, by inference, had knowledge of the subrogation agreement between plaintiff and its insured when the release was obtained. Therefore, the release would not bar a recovery by plaintiff.[1]

The rule announced by the court is considered the orthodox rule of insurance law,[2] but apparently the problem had not previously arisen in Ohio.[3] A similar rule has, however, long been applied to assignments of debts where the debtor, with knowledge of an assignment by his creditor, pays the debt to the original creditor and then attempted to assert the payment as a defense against the assignee.[4] Knowledge on the part of the tortfeasor, or the debtor, of a subrogation agreement or assignment is the key to the application of the rule in either situation. In the absence of such knowledge the tortfeasor or debtor should have the right to settle with an injured person or pay a creditor without fear of being required to pay a second time to a subrogee or assignee whose existence is unknown to him.

The problem presented in the principal case may easily arise under collision insurance contracts, which normally contain deductibility clauses. In *Allstate Insurance Co. v. Dye*,[5] decided one month after the principal case, an insurer sued its *insured* to recover back the amount which it had paid to the insured under an insurance contract having a $50 deductible clause. The defendant insured had given the tortfeasor a general release, without re-

[1] Motorists Mut. Ins. Co. v. Gerson, 113 Ohio App. 321, 17 Ohio Op. 2d 333, 177 N.E.2d 790 (1960).

[2] Vance, Insurance § 134 (3d ed. 1951); Annot., 51 A.L.R.2d 699 n.3 (1957); Annot., 105 A.L.R. 1433 (1936); Annot., 54 A.L.R. 1455 (1928).

[3] See Motorists Mut. Ins. Co. v. Gerson, *supra* note 1, at 323, 17 Ohio Op. 2d at 334, 177 N.E.2d at 792.

[4] P.C.C. & St. L. Ry. Co. v. Volkert, 58 Ohio St. 362 (1898); Fire Ass'n v. State Auto. Mut. Ins. Co., 29 Ohio L. Abs. 135 (Ct. App. 1938); Restatement, Contracts § 170 (1932).

[5] Allstate Ins. Co. v. Dye, 113 Ohio App. 90, 170 N.E.2d 862 (1960).

serving plaintiff insurer's right of subrogation, before receiving payment under the policy from plaintiff. Plaintiff later paid the amount of the property damage, less $50, to defendant insured, without knowledge of the settlement and release. In his answer, defendant denied that he had compromised any portion of plaintiff's subrogation claim. The trial court entered summary judgment in favor of plaintiff and the court of appeals affirmed, finding that there was no dispute that defendant had settled his entire claim against the tortfeasor by giving him a full release without any reservation of plaintiff's right to seek reimbursement against the tortfeasor under its subrogation agreement. The court of appeals stated that even if the defendant insured had notified the tortfeasor of his pending claim with plaintiff insurer, plaintiff could still recover, since defendant would have prejudiced plaintiff's rights against the tortfeasor. The court made it clear, however, that if the tortfeasor had been notified of payment and a subrogation agreement, the insurer could not recover from its insured, since in that event its right of subrogation would not be impaired. Other jurisdictions have likewise held that where the tortfeasor obtains a release from the insured without knowledge of a prior subrogation agreement, the subrogated insurer cannot recover in a suit against the tortfeasor.[6]

The principal case and *Dye* are quite consistent. Both require knowledge by the tortfeasor of the subrogation agreement as a condition precedent to recovery by the insurer where the insured has given an unqualified release to the tortfeasor. The significance of the principal case is the manner in which the court established knowledge of the subrogation on the part of the tortfeasor. No evidence was presented to show that the tortfeasor had actual knowledge of the subrogation agreement or actual knowledge that the insured was covered by collision insurance. However, the court drew an inference of such knowledge from the following facts: (1) The $50 received by the insured was paid by an insurance agent representing the tortfeasor; (2) From observing the insured's automobile after the accident, the tortfeasor must have known that the insured suffered more than $50 damage; and (3) $50 was the exact amount of the deductible portion of the collision policy.

Subrogated insurance companies are now protected to some extent by the adoption of the rule in the principal case in situations where the insured has given a release but has received nothing in excess of his loss as consideration,[7] provided that the tortfeasor has at least constructive knowledge of the subrogation. In *Pacific Fire Insurance Co. v. Wyatt*,[8] the insurer brought an action against its insured to recover the amount paid under the policy. The insured had executed a full release to the tortfeasor in consideration of a sum of money paid for the damages in excess of the amount paid by the insurer,

[6] American Auto. Ins. Co. v. Clark, 122 Kan. 445, 252 Pac. 215 (1927). See also authorities cited note 2 *supra*.

[7] Casualty Co. v. Rees Co., 71 Ohio App. 361, 50 N.E.2d 347 (1942); Pacific Fire Ins. Co. v. Wyatt, 35 Ohio L. Abs. 336, 49 N.E.2d 947 (Ct. App. 1940). *But see* Norwich Union Fire Ins. Soc. v. Stang, 18 Ohio C.C.R. 464, 9 Ohio C.C. Dec. 576 (1899).

[8] 35 Ohio L. Abs. 336, 40 N.E.2d 947 (Ct. App. 1940).

the release having been given after the payment under the policy by plaintiff insurer to defendant insured. The court held that the insurer could not recover since the insured had received only that to which he was entitled. The principal case would seemingly allow the insurer to recover from the *tortfeasor* in a situation similar to that in *Wyatt* if he can show constructive knowledge by the tortfeasor of a subrogation agreement when the release was obtained. The proof of such knowledge is greatly facilitated by the inferences drawn in the principal case. This is especially true where the amount received from the tortfeasor is only a small fraction of the total damage suffered by the insured.

The release problem was probably a source of confusion in *Hoosier Casualty Co. v. Davis*,[9] decided subsequent to the principal case. In *Hoosier Casualty* the insured had previously filed suit against the tortfeasor for personal injuries. Prior to trial the claim was settled, and the suit was accordingly dismissed with prejudice. The subrogated insurer then brought suit against the tortfeasor to recover that portion of the property damages which it had paid to its insured. In its answer, as a second defense (there were actually *two* separate and distinct defenses, release and res judicata), defendant alleged the commencement of the personal injury action, the settlement and dismissal with prejudice, and further alleged that insured had executed a release of all claims in favor of the tortfeasor. The plaintiff insurer apparently did not move to require the defendant to separately state and number the two defenses in the so-called second defense but did file a reply denying the release for want of information, and alleging notification to the tortfeasor, prior to the commencement of the personal injury action, of the extent of payment made to insured by plaintiff insurer. The trial court sustained defendant's motion for judgment on the pleadings, but the Supreme Court of Ohio ultimately reversed. The opinion of the court failed to note the presence of the two distinct defenses of release and res judicata, and accordingly failed to deal explicitly with either defense. The defense of release should have been disposed of on two grounds: (1) Plaintiff denied the release in its reply, and (2) Plaintiff avoided the release in its reply alleging that it gave notice of the subrogation agreement to the tortfeasor prior to the commencement of the personal injury action. This allegation amounted to an avoidance of the defense of release because of the basic principle referred to previously that payment to a creditor (or compromise with a tort claimant) by a debtor (or tortfeasor) with knowledge of a previous assignment (or subrogation) is no defense to a subsequent action by an assignee (or subrogee). Either the denial or the avoidance in the reply would have prevented affirmance of the judgment on the pleadings on the basis of the release defense. With the release defense thus eliminated from consideration as a possible justification for affirming the judgment on the pleadings, the court might have made a more satisfactory analysis of the defense of res judicata. Although the result reached by the court was correct, its opinion fails to state any general principle upon which its holding is based. To some extent the concurring opinion

[9] 172 Ohio St. 5, 173 N.E.2d 349 (1961), noted, 22 Ohio St. L.J. 763 (1961).

of Taft, J., supplies the omission by pointing out that failure of the tortfeasor to object to the nonjoinder of a subrogor or subrogee constitutes a waiver of such nonjoinder. (Such failure to object might also be said to amount to a consent by the tortfeasor to the maintenance of two actions against him upon the same cause of action.) However, even the concurring opinion blurs the distinction between the defense of release and the defense of res judicata. Although the concurring opinion is obviously directed toward the defense of res judicata, it cites as its basis the decision in *Railway Co. v. Volkert*.[10] That case involved the defense of payment to a partial assignor. It did not involve in any way the defense of res judicata.

It is apparent from the result of the principal case that a release obtained by the tortfeasor's liability insurer, the consideration being the amount of the deductible portion of a collision policy, will usually not bar an action by the insurer against the tortfeasor since knowledge of the subrogation agreement on the part of the tortfeasor's liability insurer will ordinarily be inferred by the court. It appears possible that such an inference could also be drawn in a case where the consideration for the release is only slightly more than the deductible portion of the collision policy. While the rule established by the principal case is new in Ohio, it evidences a policy that has existed elsewhere for a long period of time.[11] The rule enforces a higher ethical standard on the representatives of liability insurance companies. A contrary holding would have condoned attempts by such representatives to defeat subrogation rights by payment to an insured of the unsubrogated portion of a claim. On the other hand, while the subrogated insurer prevailed in the present case, as a matter of self-protection a collision insurer should make every effort to give immediate notice to the tortfeasor of the insurer's right of subrogation.[12]

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[10] 58 Ohio St. 362 (1898).

[11] See authorities cited note 4 *supra*.

[12] As was allegedly done in Hoosier Cas. Co. v. Davis, *supra* note 9.